

Natural Gas Market Prices Monthly Update



September 2, 2003

NATURAL GAS MARKET PRICE UPDATE

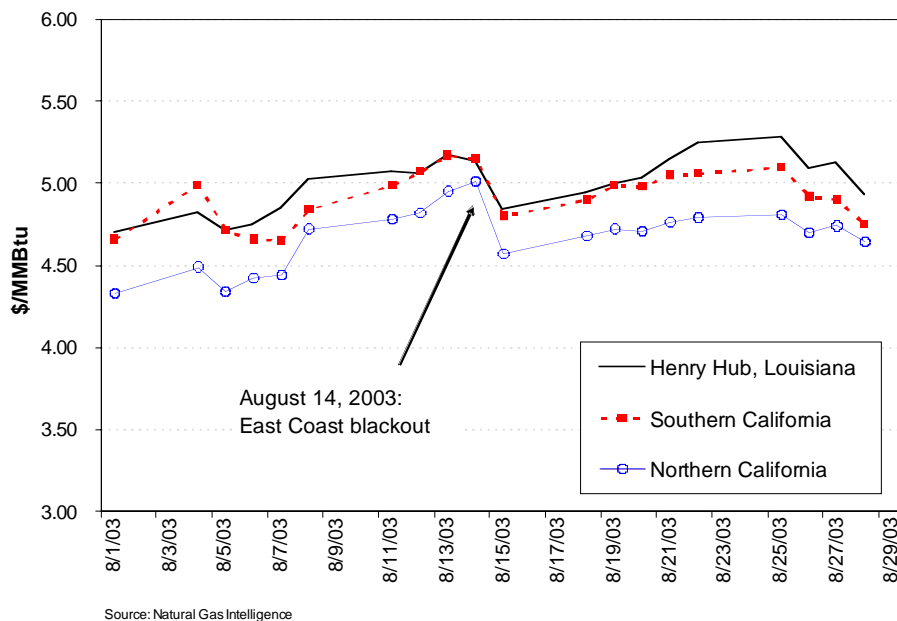
On March 13, 2003, Governor Davis asked the California Energy Commission (Energy Commission) and the California Public Utilities Commission (CPUC) to review the unexpectedly rapid rise in natural gas market prices that occurred in late February 2003. He also asked that the two commissions issue a report to his office and provide a monthly update of any additional findings

This report provides an update on natural gas prices in California for the month of August 2003 and the natural gas storage inventory levels for both the state and the nation. Next month, we expect to report on an upcoming meeting with FERC staff on price spike investigations and the opportunity to coordinate on future investigations.

Recent California Natural Gas Prices

California natural gas prices increased modestly during August 2003, and generally stayed below the national benchmark price. Figure 1 compares the natural gas prices in Northern and Southern California to the national Henry Hub prices. During the first half of August 2003, natural gas prices increased due to higher natural gas use by electricity generators to serve increasing air conditioning loads as summer heat spread throughout much of the country. Earlier in the summer, hot temperatures had been mostly confined to the Southwest and interior of California. Additionally, rising crude oil prices and a U.S. EIA storage report which showed that storage inventories were on the low end of market traders' expectations put upward pressure on natural gas futures prices.

Figure 1



The early August price increases briefly declined following a historic power outage in the Northeastern U.S. and parts of Canada, which temporarily disrupted electricity generation and industrial gas demand in the affected areas. This August 14, 2003 blackout also masked any bullish effect that Tropical Storm Erika might have had, as the storm reduced some natural gas production areas on its quick pass through the Gulf of Mexico. Prices resumed a modest climb in the aftermath of the blackout, however, as gas-fired power plants came back on-line more quickly than non-gas fired generators, particularly nuclear and coal-fired facilities.

Natural Gas Storage Inventories

In previous reports, we stressed the need for natural gas storage inventories to be at adequate levels for winter 2003-2004 to reduce the impacts of national price spikes on California gas consumers. Maintaining adequate inventories is a key to providing flexibility for gas buyers and sellers to balance supply and demand, thus achieving a stable and reliable supply. Adequate storage also buffers volatile price movements in the market place by providing additional supplies that are inside the state and have already been purchased.

The Energy Commission and CPUC staff has monitored storage levels closely for the past few years and continue to do so. Fortunately, California is better prepared for this coming winter than the rest of the U.S. and will very likely achieve its target storage levels by November 1, 2003.

We estimate that 153 billion cubic feet (Bcf) of inventories provides the minimum needed to serve the peak needs of California's core customers during short periods of very high demand and/or national price spikes, a level needed by November 1 of each year. As of September 1, 2003 California storage inventories were at 195 Bcf. Figure 2 shows the recent advances in California storage inventories. To satisfy demand for this upcoming winter, California storage customers have injected about 96 Bcf since April 1, 2003, the traditional date to begin refilling storage facilities. As a result, storage inventories are well on their way to the maximum storage capacity level of 243 Bcf. While only about 9 Bcf had been injected into storage during August 2003, this net injection compares favorably with a net withdrawal of 2 Bcf for the five year average for August. On average, the daily temperatures in August can vary from hot to very hot. This variability means that the gas utilities are withdrawing gas some days and injecting gas other days. This year, the utilities and private storage customers were able to inject slightly more than they withdrew.

In addition, California will further benefit from the accelerated availability of the Wild Goose Storage expansion project when it comes on line November 1, 2003, instead of next spring. Although the increased storage becomes available rather late in the injection season, this new infrastructure will provide additional benefits to California. There will often be short windows during the heating season when demand will be moderate and less than planned supplies. Thus, additional supplies will be available at the last minute that can be injected into storage, assuming market prices are reasonable.

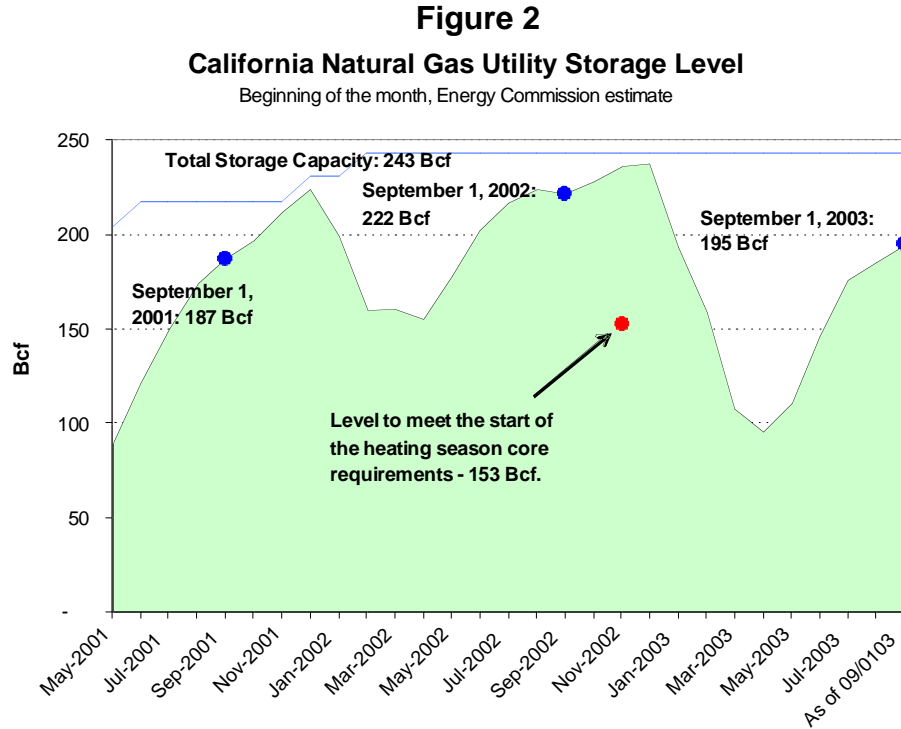
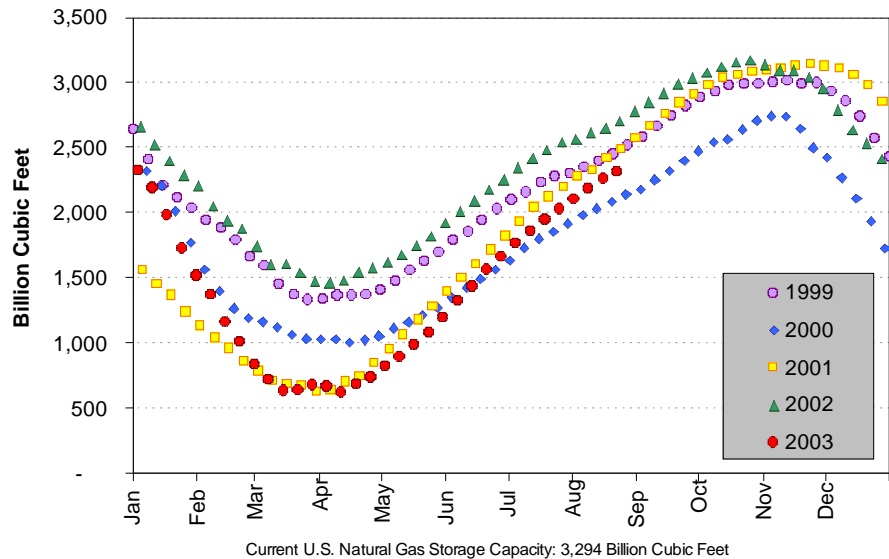


Figure 3 compares weekly storage levels in the U.S. during the past four and one-half years. We are more comfortable this month than before regarding the national storage levels since they have been rapidly increasing. While U.S. storage inventories are still well below needed levels, the utility and storage customers are continuing to inject gas into storage at a rapid rate. For the week ending August 22, 2003, 53 Bcf were injected nationally. Storage levels are now only 7% below the 5 year average. Over the 11 weeks following August 22, 2003, nationwide storage injections must average about 67 Bcf per week for inventories to reach the desired level of 3,000 Bcf by November 1. Since the natural gas demand normally subsides in the next two months due to cooler weather, additional gas should be available for injection, leading most analysts to believe that the 3.0 trillion cubic feet (Tcf) in storage inventories needed to provide a comfortable buffer for the U.S. winter peak demand will be achieved.

Figure 3

U.S. Natural Gas Storage Levels

Sources: EIA/AGA



Since some of the natural gas purchased and injected during this season is more expensive than in previous years, it raises concerns that consumers' prices for the 2003-2004 winter will continue to remain high, as this more expensive stored gas is withdrawn and used or sold. Despite these anticipated higher prices, adequate storage inventories are essential for utilities to maintain reliable deliveries to customers and mitigate the potential for supply curtailments and extreme price spikes in the coming winter.

In summary, California's natural gas market outlook continues to improve compared to earlier expectations, primarily due to significant efforts to increase storage inventories. At this point, we have a diminished concern for supply reliability assuming weather patterns within reasonable bounds, but continue to be concerned about above average natural gas prices and their impact on consumers' bills this winter. We will report any significant emerging issues in the next *Energy Commission/CPUC Natural Gas Market Price Report*.